

Message Text

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PAGE 01 OTTAWA 04215 01 OF 02 272058Z
ACTION EUR-12

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OMB-01 PM-05 OES-09 SP-02 SS-15 STR-07 TRSE-00
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FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC NIACT IMMEDIATE 8487

INFO ALL CONGENS IN CANADA POUCH

C O N F I D E N T I A L SECTION 01 OF 02 OTTAWA 04215

DOE FOR GOLDMAN AND BERGOLD
DOE/FERC FOR SMITH AND ADGER

E.O. 11652: GDS

TAGS: ENRG, CA

SUBJECT: GOC ELABORATES NEW GAS-OIL PRICE POLICY

REFS: A. OTTAWA 4213; B. OTTAWA 4212

1. SUMMARY. IN PRESS CONFERENCE AUGUST 25, ENERGY, MINES AND RESOURCES MINISTER GILLESPIE ELABORATED ON NEW GAS-OIL PRICE POLICY -- EMPHASIZING OBJECTIVE OF LOWER DOMESTIC GAS PRICES TO ENCOURAGE CONSUMPTION AND TYING FUTURE ADDITIONAL EXPORTS TO U.S. TO INCREASED DOMESTIC USE. TAKING NO PAINS TO SOFTEN BLOW TO GAS PRODUCERS AND ALBERTA GOVERNMENT, GILLESPIE SAID BURDEN OF LOWER PRICES WOULD HAVE TO BE BORNE BY PRODUCERS WHO COULD ALSO BENEFIT FROM INCREASED DOMESTIC SALES AND FROM HIGHER-PRICED EXPORTS -- IF DOMESTIC USE INCREASED. GILLESPIE MADE CLEAR HE WAS SIGNALLING NATIONAL ENERGY BOARD TO PROJECT HIGHER DOMESTIC USE IN ITS COMING GAS SUPPLY-
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PAGE 02 OTTAWA 04215 01 OF 02 272058Z

DEMAND STUDY.

2. CONTENT AND MANNER OF POLICY CHANGE CAN ONLY INTENSIFY FEDERAL-PROVINCIAL CONTENTION OVER ENERGY POLICY AND MAY THREATEN EARLY START ON PREBUILDING OF ALASKA GAS PIPELINE. SPREAD BETWEEN DOMESTIC AND EXPORT GAS PRICES PROMISES TO WIDEN. STATEMENTS MADE SO FAR LEAVE SOME

ASPECTS OF NEW POLICY AMBIGUOUS. WE WILL SEEK CLARIFICATION. END SUMMARY.

3. IN FOLLOW-UP TO AUGUST 24 ANNOUNCEMENT BY FINANCE MINISTER CHRETIEN OF CHANGE IN GOC OIL AND GAS PRICE POLICY (REF A.), ENERGY, MINES AND RESOURCES MINISTER ALASTAIR GILLESPIE EXPLAINED SOME OF NEW POLICY'S IMPLICATIONS AT NEWS CONFERENCE AUGUST 25. GILLESPIE IS WIDELY REPORTED AS SAYING THAT GOC'S INTENTION TO ALLOW MORE FLEXIBILITY IN DOMESTIC GAS PRICE, ANNOUNCED BY CHRETIEN, IS SIGNAL TO ALL PARTIES THAT DOMESTIC USE OF NATURAL GAS MUST BE EXPANDED BEFORE ADDITIONAL EXPORTS TO U.S. WILL BE AUTHORIZED. GILLESPIE STRESSED THAT GOC ANNOUNCED ITS POSITION NOW SO THAT NEW POLICY WOULD BE TAKEN INTO ACCOUNT BY NATIONAL ENERGY BOARD IN ITS GAS SUPPLY-DEMAND STUDY, FOR WHICH HEARINGS ARE TO BEGIN IN OCTOBER. (NEB STUDY IS TO GIVE OFFICIAL VIEW ON GAS RESERVES -- IN LIGHT OF RECENT LARGE NEW ADDITIONS -- AND TO PROJECT CANADIAN DEMAND AND EXPORT AVAILABILITY.)

4. QUESTIONED ABOUT PROSPECTS FOR EXPORTS, GILLESPIE IS REPORTED TO HAVE SAID THAT GOC EXPECTS TO SEE EXPANSION OF GAS USE IN EASTERN CANADA BEFORE THERE ARE ADDITIONAL EXPORTS TO U.S. GILLESPIE SAID THAT PRIORITY MARKET FOR ADDITIONAL GAS WAS WITHIN CANADA, RATHER THAN EXPORT. "WE SHOULD BE LOOKING AT CANADIAN SOLUTION -- CANADIAN CONFIDENTIAL

CONFIDENTIAL

PAGE 03 OTTAWA 04215 01 OF 02 272058Z

GAS FOR CANADIANS," HE SAID.

5. IN EXPLAINING EFFECT OF NEW POLICY ON DOMESTIC GAS PRICES, GILLESPIE SAID PRICE IS EXPECTED TO FALL BY 50-75 CANADIAN CENTS PER MCF AND THAT IN SEVERING RELATIONSHIP BETWEEN GAS AND OIL PRICES, NOW FIXED AT 85 PER CENT OF COMMODITY VALUE, RATIO COULD FALL TO BETWEEN 50-65 PER CENT. HOWEVER, BOTH CHRETIEN AND GILLESPIE REFERRED TO NEW POLICY AS FREEING GAS TO SEEK ITS MARKET VALUE "WITHIN A RANGE" AND THAT SOME PRICES MIGHT INCREASE -- SUGGESTING THAT PRICES WILL CONTINUE TO BE ADMINISTERED BUT UNDER NEW GUIDELINES.

6. GOC IS REPORTED TO EXPECT PRODUCERS TO ABSORB PRICE DECREASE IN THEIR NET-BACK, WITH EFFECT ON THEIR CASH FLOW MODERATED BY HIGHER PRODUCTION. TO EXTENT ADDITIONAL EXPORTS ARE ALLOWED, HIGHER RETURN ON FOREIGN SALES WOULD ALSO HELP TO OFFSET LOWER UNIT EARNINGS FROM DOMESTIC SALES.

7. ON OIL PRICES, GILLESPIE REITERATED THAT ALBERTA-FEDERAL AGREEMENT ON RAISING DOMESTIC PRICE TO WORLD LEVEL

PROVIDED THAT CANADIAN PRICE (AT TORONTO) WOULD NOT RISE ABOVE AVERAGE U.S. PRICE (AT CHICAGO) TO PROTECT CANADIAN USERS FROM BEING COMPETITIVELY DISADVANTAGED. PRICE SPREAD IS NOW ONLY 31 CANADIAN CENTS, ACCORDING TO GILLESPIE, WHICH WOULD NOT LEAVE ROOM FOR ONE DOLLAR INCREASE TO GO INTO EFFECT IN JANUARY AS SCHEDULED. GILLESPIE SEEMED TO IMPLY, HOWEVER, THAT POLICY HAD NOT CHANGED AND THAT CANADIAN PRICES WOULD INCREASE AGAIN AS U.S. (AND OTHER) PRICES RISE.

8. ONLY OFFICIAL ALBERTA GOVERNMENT REACTION SO FAR TO ANNOUNCEMENTS IN OTTAWA, HAS BEEN CAREFUL COMMENT BY ENERGY MINISTER GETTY SAYING THAT ALBERTA WILL APPLY TO THE LETTER AGREEMENT WITH GOC ON OIL AND GAS PRICING. CONFIDENTIAL

CONFIDENTIAL

PAGE 04 OTTAWA 04215 01 OF 02 272058Z

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PAGE 01 OTTAWA 04215 02 OF 02 272102Z
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C O N F I D E N T I A L SECTION 02 OF 02 OTTAWA 04215

IN MODERATE TONES, GETTY CRITICIZED FEDERAL ANNOUNCEMENT NOW ABOUT FOREGOING JANUARY PRICE INCREASE AS PREMATURE AND LAMENTED LACK OF PRIOR CONSULTATION.

9. PRESS REPORTS GOC EXPECTS TO OPEN DISCUSSIONS WITH ALBERTA ON NEW PRICE POLICY WITHIN FEW WEEKS AND THAT IT

IS PREPARING TO LEGISLATE CHANGES IF FEDERAL-PROVINCIAL AGREEMENT CANNOT BE REACHED.

10. COMMENT: APPARENT IMPLICATIONS FOR GAS EXPORTS TO U.S. FROM GOC ANNOUNCEMENTS ARE: A) GOC IS PREPARED TO ACCEPT DELAY IN PREBUILDING OF SOUTHERN SECTIONS OF ALASKA GAS PIPELINE WHILE IT USES CONTROL OVER EXPORTS AS BOTH CARROT AND STICK TO FORCE SUBSTITUTION OF DOMESTIC GAS FOR FOREIGN OIL, AND B) SPREAD BETWEEN EXPORT AND DOMESTIC GAS PRICES WILL RAPIDLY WIDEN RATHER THAN CONTINUE TO CLOSE.

11. SUDDEN ANNOUNCEMENT OF NEW POLICY SEEMS TO HAVE TAKEN ALL PARTIES BY SURPRISE, ESPECIALLY IN LIGHT OF GOC-ALBERTA AGREEMENT LESS THAN TWO MONTHS AGO ON IMPLEMENTA-CONFIDENTIAL

CONFIDENTIAL

PAGE 02 OTTAWA 04215 02 OF 02 272102Z

TION OF PRICE INCREASES AS SCHEDULED LAST JULY FIRST. AMBIGUITIES IN POLICY AS ANNOUNCED ALSO SUGGEST IT MAY HAVE BEEN IMPROVISED AROUND ELECTION STRATEGY RATHER THAN DEVELOPED AS CONSIDERED CHANGE. POLICY PROMISES LOWER TOTAL ENERGY COSTS IN LIBERAL-DOMINATED EAST AT EXPENSE OF GAS PRODUCERS IN CONSERVATIVE WEST. DEVELOPMENTS SHOULD ALSO BE SEEN AS PART OF FEDERAL-ALBERTA RIVALRY IN ENERGY FIELD. LAST MONTH'S TAKEOVER OF HOME OIL BY AGTL, WHICH PUSHED ASIDE EARLY PROPOSAL BY FEDERAL PETROCAN, WAS VIEWED AS VICTORY FOR ALBERTA INTERESTS. THESE DEVELOPMENTS SHOW GOC STILL HAS POWERFUL INSTRUMENTS IT CAN USE.

12. AUTHORITATIVE SOURCES HAVE NOT BEEN AVAILABLE OVER WEEK-END, BUT WE WILL SEEK FURTHER COMMENT AND CLARIFICATION CONCERNING POLICY CHANGES. PLACKE

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